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In The
Supreme Court of the United States

MEADWESTVACO CORPORATION, successor in interest to THE MEAD CORPORATION,

Petitioner,

v.

ILLINOIS DEPARTMENT OF REVENUE, DIRECTOR OF THE ILLINOIS DEPARTMENT OF REVENUE, AND TREASURER OF THE STATE OF ILLINOIS,

Respondents.

On Writ Of Certiorari To The Appellate Court Of Illinois

AMICUS CURIAE BRIEF IN SUPPORT OF PETITIONER, MEADWESTVACO CORPORATION, SUCCESSOR IN INTEREST TO THE MEAD CORPORATION, SUBMITTED ON BEHALF OF GANNETT CO., INC.

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QUESTION PRESENTED

Is the attempt by Illinois to tax the approximately $1 billion gain realized by Petitioner when it sold its investment in Lexis/Nexis in 1994 (which it acquired in 1968 for $6 million and which functioned for 26 years as an independent, nonunitary business) in direct conflict with the Due Process and Commerce Clauses of the United States Constitution and the decisions of the Court?

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INTEREST OF THE *AMICUS CURIAE*[1]

Pursuant to Rule 37.2 of the Rules of this Court and this Court's Order dated September 25, 2007, Gannett Co., Inc. ("Gannett") respectfully submits this brief as *amicus curiae* in support of Petitioner MeadWestvaco Corporation ("Petitioner").

Gannett is the parent corporation of an affiliated group of corporations and other business entities with operations in the United States, the United Kingdom, and elsewhere. Gannett is a leading international news and information company. In the United States, the company publishes 85 daily newspapers, including *USA TODAY*, and nearly 1,000 non-daily publications. The company is the largest newspaper publisher in the United States, and also operates Internet sites offering news and information customized to the market served. In addition, Gannett carries on publishing operations in the United Kingdom, operating as Newsquest, including 18 daily newspapers and almost 300 non-daily publications. Gannett's other principal business segment is its broadcasting segment that operates 23 broadcast television stations in the United States with a market reach of over 20.1 million households.

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[1] No counsel of a party authored this brief in whole or in part, and no person or entity, other than the *amicus curiae*, made a monetary contribution to the preparation or submission of this brief. All parties have consented to the filing of this brief, and the letters of consent of both Petitioner and Respondents have been filed with the Court pursuant to Rule 37.2(a).

As a publicly traded corporation, Gannett must file various public documents with the Securities and Exchange Commission ("SEC"). Like all public companies, Gannett must determine its business segments and report these in its public financial statements filed with the SEC. Currently, Gannett has determined that its largest business segment is newspaper publishing and its other business segment is television broadcasting. Although newspaper publishing has always been Gannett's largest segment, in the past it has operated other reportable business segments, including outdoor advertising and cable television.

Like any responsible parent corporation, Gannett approves its subsidiaries' capital budgets and may contribute capital to its newspapers, television stations, and internet businesses whether they are in start-up mode or mature. Likewise, Gannett maintains a cash management system to facilitate sound financial accounting controls for cash and accurate quarterly reporting of Gannett's cash position in SEC filings.

Gannett is presently involved in litigation in a number of States, including Illinois, Maine, and Montana. This litigation presents questions regarding the proper state income tax treatment of capital gains recognized by a subsidiary of Gannett that disposed of a cable television business that Gannett acquired in December 1995 as part of its acquisition of Multimedia, Inc., and held for a little over four (4) years before selling the assets to Cox Communications, Inc.

in January 2000. The issue is also the subject of ongoing controversies that may eventually be litigated in several additional States.

Gannett believes that the Illinois Appellate Court's decision below improperly interpreted this Court's "operational versus investment function test" in a way that effectively removes the unitary business principle, in general, and specifically, the operational function test, as a meaningful limitation on the reach of States to tax the income of non-domiciliary taxpayers from interstate business activities. This is a field in which Gannett has a major interest.

SUMMARY ARGUMENT

The decision of the Illinois Appellate Court should be reversed, because that court erroneously held that evidence of corporate stewardship and oversight was sufficient to find the operational function requirement satisfied. The lower court also failed to appreciate the significance that diversity in lines of business should have in determining whether one line of business serves an operational function for the activities of a different, diverse line of business.

One of the key functions of management when serving as responsible corporate stewards for shareholders of a public company is financial oversight and transparent financial reporting. Among the common oversight roles of management are approval of capital budgets, cash management, and financial statement

reporting in accordance with promulgated standards. Management may also alter a subsidiary's capital structure and an affiliated group's organizational structure for a variety of reasons having nothing to do with operations, such as to limit legal liability or maximize its return on assets. The Illinois Appellate Court thought these standard stewardship and oversight activities caused the assets of a diverse business segment to serve an operational function for its corporate owner and, therefore, the lower court's decision should be reversed.

In addition to Petitioner's stewardship and oversight, the Illinois Appellate Court found an operational function because the lower court believed Petitioner was not a passive investor, and because Petitioner held greater than a minority investment in Lexis/Nexis. This reasoning says nothing of whether the Lexis/Nexis assets were used in or operationally related to Petitioner's paper, packaging, office and school supply business activities carried on in Illinois and elsewhere. Further, the Illinois Appellate Court was persuaded by Petitioner's business segment reporting of Lexis/Nexis in its annual and interim public financial reports to shareholders pursuant to standards promulgated by the Financial Accounting Standards Board ("FASB"). FASB's mission is to establish and improve financial accounting and reporting. The FASB standards promote financial transparency for shareholders, investors and the capital markets. However, the precedents of this Court, not FASB pronouncements, should determine

when an investment serves an operational or investment function. Petitioner's reporting of Lexis/Nexis as a separate business segment emphasizes the differences between Lexis/Nexis and Petitioner's other businesses. As a result, this reporting is consistent with this Court's precedents and the nonoperational use and relationship of Lexis/Nexis to Petitioner's other businesses.

ARGUMENT

I. THE TEST OF OPERATIONAL FUNCTION SHOULD REQUIRE AN INQUIRY INTO WHETHER DISPOSED ASSETS WERE USED IN OR OPERATIONALLY RELATED TO UNITARY BUSINESS ACTIVITIES IN THE TAXING STATE.

The "operational versus investment function test" is an alternative test or means by which a taxing State may reach the income of interstate business activities in the absence of a direct unitary relationship between an investor and investee (or payee and payor of income). *Allied-Signal, Inc. v. Director, Division of Taxation*, 504 U.S. 768, 787 (1992). Therefore, in the absence of a direct unitary business relationship, a State may still tax income from interstate business activities consistent with the unitary business principle of the Due Process and Commerce Clauses if "the capital transaction serve[d] an operational rather than an investment function." *Allied-Signal*, 504 U.S. at 787.

Although an alternative test, the "operational versus investment function test" complements the unitary business principle. That is, it is also a " . . . necessary limit on the States' authority to tax value or income that cannot in fairness be attributed to the taxpayer's activities within the State. It is this second component, the necessity for a limiting principle, that underlies this case." *Allied-Signal*, 504 U.S. at 780. Thus, "the relevant unitary business inquiry, [is] one which focuses on the objective characteristics of the asset's use and its relation to the taxpayer and its activities within the taxing State." *Id.* at 785. *See also Allied-Signal*, 504 U.S. at 793 (O'Connor, J. dissenting) ("Whether an investment is short-term or long-term, what matters for due process purposes is whether the investment is operationally related to the in-state business.") None of the factors relied on by the Illinois Appellate Court show that the Lexis/Nexis assets were used in or operationally related to Petitioner's unitary business activities in Illinois so as to be an "integral operational" part of those activities. *Allied-Signal*, 504 U.S. at 788.

For instance, in *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 (1983), the taxpayer's loans and loan guarantees served an operational function because they helped the taxpayer's overseas operations to continue growing and "to become a more substantial part of the" activities of the taxpayer's vertically integrated enterprise. 463 U.S. at 180, n. 19. In *Container* this Court also noted that *Corn Products Refining Co. v. Commissioner*, 350

U.S. 46 (1955), was "another context [where] capital transactions can serve either an investment function or an operational function." *Id.* In *Corn Products*, corn futures hedging transactions were held to result in recognition of ordinary income not capital gains, as the futures transactions were integrally tied to the taxpayer's ordinary business activities. The taxpayer was engaged in the business of converting corn into starches, sugars, and other products and hedged corn purchases to assure itself a steady supply of corn and to protect itself against price increases. Conversely, financial oversight, such as that related to capital structure, debt, and dividends found in *F.W. Woolworth Co. v. Taxation & Revenue Department of New Mexico*, 458 U.S. 354 (1982), did not rise to the level of an operational function. *Container*, 463 U.S. at 180, n. 19. Among other factual stipulations relevant to the Court's holding in *Allied-Signal*, the parties had stipulated that "[n]one of Asarco's activities, businesses or income (in New Jersey or otherwise) were related to or connected with Bendix's activities, business or income (in New Jersey or otherwise)." *Allied-Signal*, 504 U.S. at 774.

Therefore, *amicus curiae* Gannett respectfully submits that whether a tangible or intangible asset of a nondomiciliary corporation serves an operational or investment function should be determined by focusing on whether the asset is used in or operationally related to the business activities of the investor carried on in the taxing State and elsewhere.

Petitioner was in the business of producing and selling paper, packaging, office and school supplies. J.A. 9. Lexis/Nexis provided online information services for legal, news and financial information in the electronic publishing market. J.A. 10. Prior to the sale, Lexis/Nexis was merged into and became a division of Petitioner. J.A. 14. In December, 1994, the sale of Lexis/Nexis to Reed Elsevier plc was completed. J.A. 14. The Illinois Appellate Court should have inquired into whether the Lexis/Nexis assets owned by Petitioner were used in Petitioner's paper, packaging, office and school supply business activities carried on in Illinois, as opposed to whether Petitioner approved Lexis/Nexis capital expenditures, "swept" cash from Lexis/Nexis, reported Lexis/Nexis on its public financial statements as a principal business segment, or altered Lexis/Nexis' capital structure or place on the corporate organization chart. As a result of its focus on these unrelated factors, the Illinois Appellate Court was not properly focused "on the objective characteristics of the [Lexis/Nexis] asset's use and [their] relation to the [Petitioner] and its activities within the taxing State" of Illinois. *Allied-Signal*, 504 U.S. at 785.

For example, Lexis/Nexis was not acquired to nor did it provide a source of supply or raw materials for Petitioner's paper, packaging, office and school supply business activities carried on in Illinois and elsewhere. It was also not acquired to nor did it serve as a distribution outlet for Petitioner's products in Illinois and elsewhere. Lexis/Nexis also was not

acquired by Petitioner to nor did it provide research and development or other services related to Petitioner's business activities in Illinois and elsewhere. Petitioner held the Lexis/Nexis assets as an investment in a diverse business enterprise, not as an operational part of its business.

A. Whether an Investment is Passive or a Minority Interest does not have Direct Relevance to Whether the Operational Function Test is Satisfied.

At various times during the 26 years that Lexis/Nexis was owned by Petitioner, Lexis/Nexis was held as a wholly-owned subsidiary or as an unincorporated division of Petitioner. The varying forms of ownership should not matter as the substance of the relationship between Lexis/Nexis and the Petitioner never changed. Nonetheless, the Illinois Appellate Court was influenced by Petitioner's ownership interest in Lexis/Nexis, and that court's view of Petitioner's role as more than that of a passive investor. Pet. App. 12a-13a. This sheds no light on whether Petitioner's use of Lexis/Nexis was operationally related to Petitioner's paper, packaging, office and school supply business activities in Illinois and elsewhere.

A passive investment does not represent an operational function for the holder of the investment because a passive investor does not use the assets in its business. However, the converse is not true. An investment could serve a nonoperational function for

the investor without being passive. For example, nonoperational cash investments could be managed by an investment bank, or actively managed by a taxpayer, and remain nonoperational investment assets.[2] Likewise, a minority investment is a mere label and says nothing of whether it serves an operational or investment function for the investor. An investment being held and overseen so that it does not waste and that is sold when the market is right or the desired offer is received is not being used in any business activity and serves an investment function of the investor whether the investor owns a minority interest or 100 percent. As this Court stressed in *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U.S. 425, 440 (1980), "[o]ne must look principally at the underlying activity not at the form of investment, to determine the propriety of apportionability." The factors relied on by the Illinois Appellate Court did not consider whether the Lexis/Nexis assets were used in or operationally related to Petitioner's unitary paper, packaging, office and school supply business activities conducted in Illinois.

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[2] *See Home Interiors and Gifts, Inc. v. Dept. of Revenue*, 741 N.E. 2d 998 (Ill. App. Ct. 2000).

B. Capital Expenditure Approval, Capital Contributions, Cash Management, and Capital or Organizational Structure Changes Serve Oversight or Stewardship Functions, not Operational Functions.

Petitioner's approval of Lexis/Nexis capital expenditures, contributions of capital, segment reporting of Lexis/Nexis in its public company financial statements, cash management system, and "manipulation" of capital and organization structure, in addition to being common to any public company, did not, by themselves or in combination, create any operational relationship for the Lexis/Nexis assets to Petitioner's Illinois business activities. Nonetheless, the Illinois Appellate Court found that Lexis/Nexis served an operational function for Petitioner solely on the basis of these common stewardship and oversight factors. Pet. App. 2a-4a, 11a-13a. These factors simply are no more than representative of "the type of occasional oversight – with respect to capital structure, major debt, and dividends – that any parent gives to an investment in a subsidiary, . . . " *F.W. Woolworth*, 458 U.S. at 369.

For example, the Illinois Appellate Court emphasized Petitioner's cash management system, which was a nightly cash "sweep" of Lexis/Nexis bank accounts to a concentration account of Petitioner. Pet. App. 3a. A cash management system is critical to a public company and promotes accounting control of cash to facilitate accurate quarterly reporting of the

company's cash position in SEC filings. In civil tax cases, unencumbered cash advances are treated as constructive dividends by the operating subsidiary to the parent corporation to the extent of the subsidiary's earnings and profits (and as a return of capital to the shareholder to the extent in excess of the subsidiary's earnings and profits). Alternatively, the cash advances may be treated as a loan if, based on a variety of factors, it is the intent of the parties that the advances be repaid. *Alterman Foods, Inc. v. United States*, 505 F. 2d 873 (*Alterman I*) (cash advances made "on demand" to parent treated as dividends); *Alterman Foods, Inc. v. United States*, 611 F. 2d 866 (Ct. Cl. 1979) (*Alterman II*) (bi-weekly cash transfers from out-of-state subsidiary bank accounts to parent's account treated as dividends); *New York Times Sales, Inc. v. Commissioner of Revenue*, 667 N.E. 2d 302 (Mass. App. Ct. 1996) (daily cash "sweeps" pursuant to cash management system from subsidiaries to parent treated as dividends). A distribution needs not be formally declared or constitute a dividend under state law to be treated as a dividend for tax purposes. *New York Times Sales*, 667 N.E.2d at 305 (citations omitted). Rather, "a distribution of property . . . made by a corporation with respect to its stock" of its accumulated and current earnings and profits is a dividend for tax purposes. 26 U.S.C. §§ 301(a), (c)(1), and 316(a). A dividend is simply a distribution of available earnings or profits under a claim of right without any expectation of repayment. *Clark v. Commissioner*, 266 F. 2d 698, 711 (9th Cir.

1959); *Livernois Trust v. Commissioner*, 433 F. 2d 879, 883 (6th Cir. 1970).

Granted, when Lexis/Nexis became a division of Petitioner, the nightly cash "sweep" could not have been a dividend distribution for tax purposes, as it would not have been a "distribution . . . by a corporation with respect to its stock." Instead, the "sweep" would have been an intra-divisional transfer of funds. Nonetheless, insofar as the operational function is concerned, this distinction should be of no constitutional significance. However viewed, the nightly cash "sweep" was a commingling of cash advances. This Court previously held that a commingling of dividend income does not have unitary significance because that "subverts the unitary-business limitation," *F.W. Woolworth*, 458 U.S. at 364, n. 11. Likewise, when the Illinois Appellate Court relied on Petitioner's cash management system as serving an operational function it subverted the unitary business limitation. The nightly cash "sweep" was invested by Petitioner for the benefit of Lexis/Nexis. J.A. 181-182. The net excess cash returned to Petitioner by the nightly cash "sweep" over the course of time was a dividend or return on its investment, but does not tell "whether in pursuing maximum profits" for Lexis/Nexis or itself "[Petitioner] treated particular intangible assets as serving, on the one hand, an investment function, or, on the other, an operational function." *ASARCO Inc. v. Idaho State Tax Comm.*, 458 U.S. 307, 328 (1982); *Allied-Signal*, 504 U.S. at 785.

A cash management system furthers the corporate or business purposes of cash accounting and reporting, maximizing profits and facilitating the movement of cash among subsidiaries or operating divisions. Even though investments or activities may serve such important purposes, these consistently have been rejected by this Court as having unitary or operational function significance. *Allied-Signal*, 504 U.S. at 788; *F.W. Woolworth*, 458 U.S. at 363; and *ASARCO*, 458 U.S. at 326.

C. Segment Reporting Serves a Management Oversight Function.

Petitioner included Lexis/Nexis as a "reportable business segment" in Petitioner's 1993 SEC Form 10-K and Annual Report to Shareholders. J.A. 83, 120. The Illinois Appellate Court found it was significant that Lexis/Nexis was described in Petitioner's annual reports as a business segment and not as an "investee." Pet. App. 13a.

In accordance with Statement of Financial Accounting Standards No. 131, *Disclosures about Segments of an Enterprise and Related Information* (1997), issued by the Financial Accounting Standards Board ("FAS 131"), all "public business enterprises" are required to report certain information about operating segments in annual financial statements and interim financial reports issued to shareholders. FAS 131, at 4. The objective of FAS 131 is to provide information about the different business activities in

which a public company engages and the different economic environments to help users of the public company's financial statements. FAS 131, at 5, ¶ 3. If an "operating segment" satisfies certain "quantitative thresholds," then it is a "reportable business segment."[3] FAS 131, at 8-9, ¶¶ 16, 18. FAS 131 became effective for fiscal years beginning after December 15, 1997, and superseded Statement of Financial Accounting Standards No. 14, *Financial Reporting for Segments of a Business Enterprise* (1976) ("FAS 14"), and related financial accounting pronouncements. FAS 14 and related pronouncements generally required public business enterprises to report segment information by industry and geographic area.

"Operating segments are components of an enterprise about which separate financial information is available that is evaluated regularly by the

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[3] In general, an "operating segment" is defined to mean "a component of an enterprise" that (1) "engages in business activities from which it may earn revenues and incur expenses . . . ", (2) "whose operating results are regularly reviewed by the enterprise's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance," and (3) "for which discrete financial information is available." FAS 131, at 7, ¶ 10. The "quantitative thresholds" that make an "operating segment" a "reportable business segment" are reported revenues that are at least 10 percent of combined revenues of all operating segments, reported profit or loss that is at least 10 percent of combined profit of segments reporting profits or 10 percent of combined loss of segments reporting losses, and assets that are at least 10 percent of combined assets of all operating segments. FAS 131, at 9, ¶ 18.

chief operating decision maker in deciding how to allocate resources and in assessing performance." FAS 131, at 4. When Petitioner in its annual and interim public financial statements issued to shareholders reported its investment in Lexis/Nexis as a "reportable business segment," that reporting was accomplished as a quantitative matter in accordance with FAS 14 and later FAS 131 to help users of Petitioner's financial statements. For example, the Association for Investment Management and Research commented during the preparation of FAS 131 that business segment data "is vital, essential, fundamental, indispensable, and integral to the investment analysis process." FAS 131, App. A, ¶ 44.

As a result, Petitioner's segment reporting did not evidence any use of or operational relationship for the Lexis/Nexis assets and Petitioner's business activities in Illinois or elsewhere. Indeed, if it did, then every "public business enterprise" that disposes of a reportable business segment recognizes apportionable income regardless of whether the underlying relationships satisfy this Court's constitutional requirements. Such a standard effectively defeats the purposes of the unitary business principle as a limitation on the taxing authority of a State in favor of a financial standard promulgated by FASB. Rather, the fact that Lexis/Nexis was required to be reported as a separate segment emphasizes the differences between Lexis/Nexis and the remainder of Petitioner's business activities. While Petitioner clearly cared about allocating resources and assessing the performance of

Lexis/Nexis, "that state of mind sheds little light on the question whether in pursuing maximum profits they treated [Lexis/Nexis] as serving, on the one hand, an investment function, or, on the other, an operational function." *Allied-Signal,* 504 U.S. at 784-785. *See also F.W. Woolworth*, 458 U.S. at 369 (the fact that taxpayer's published financial statements were prepared on a consolidated basis did not make the taxpayer and its foreign subsidiaries unitary).

Petitioner's segment reporting served public financial reporting requirements and represented a management oversight function for Petitioner that was required by FASB.

II. A DIFFERENT LINE OF BUSINESS THAT IS NOT IN A UNITARY RELATIONSHIP WITH ANOTHER LINE OF BUSINESS CONDUCTED IN THE TAXING STATE CANNOT SERVE AN OPERATIONAL FUNCTION FOR THAT LINE OF BUSINESS.

In the task of determining whether a unitary business relationship exists, or whether an investment serves an operational or investment function, differences in lines of business are significant. *See Container*, 463 U.S. at 178 ("Investment in a business enterprise truly 'distinct' from a corporation's main line of business often serves the primary function of diversifying the corporate portfolio and reducing the risks inherent in being tied to one industry's business cycle.") Petitioner's "main line of business" was paper,

packaging, and office and school supplies, whereas Lexis/Nexis provided online information services for legal, news and financial information in the electronic publishing market. J.A. 9, 10. In fact, Petitioner's business segment reporting highlights the diversity in the lines of business. Lexis/Nexis provided diversification from Petitioner's paper, packaging, office and school supplies business activities. Although Petitioner's cash management system performed the nightly cash "sweep" of Lexis/Nexis' bank accounts (and arguably benefited Lexis/Nexis by investing the funds for Lexis/Nexis' benefit), "it is also true that they are 'discrete business [enterprises]' that – in 'any business or economic sense' – have 'nothing to do with the activities' of" Petitioner in Illinois. *ASARCO*, 458 U.S. at 328 (citing *Mobil Oil*, 445 U.S. at 439-442). Petitioner's nightly cash "sweep" of Lexis/Nexis bank accounts represented nothing more than a "mere flow of funds arising out of a . . . distinct business operation." *Container*, 463 U.S. at 166.

It is difficult to fathom how assets that are used in one line of business can serve an operational function for the activities of another line of business that is diverse (and not unitary) with the former. For example, in *Container* the parent corporation's intercompany loans and loan guarantees served an operational function, because the parent and its foreign subsidiaries were engaged in vertically integrated business activities in the same line of business. *Container*, 463 U.S. at 178, 180 n. 19. Thus, any growth of overseas business activities in *Container* served operational

functions of the same or similar business activities in California (and the United States).

The Illinois Circuit Court found that Petitioner and Lexis/Nexis were not engaged in a unitary business relationship. Pet. App. 39a. This ruling was not disturbed or addressed by the Illinois Appellate Court on appeal. Pet. App. 11a. Thus, in the absence of a direct unitary relationship between diverse lines of business, the assets of Lexis/Nexis should not be viewed as an operational function of Petitioner's paper, packaging, office and school supplies business activities conducted in Illinois and other States.

CONCLUSION

For the foregoing reasons, *amicus curiae* Gannett Co., Inc. respectfully requests this Court to reverse the decision of the Illinois Appellate Court below.

Respectfully submitted,

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